

CITY OF NATIONAL CITY
NATIONAL CITY, CALIFORNIA

Single Audit Report on Federal Awards

Year ended June 30, 2006



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The Honorable Members of the City Council
City of National City
National City, California

In planning and performing our audit of the financial statements of the City of National City, California (City) for the year ended June 30, 2006, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurances on the internal control structure. However, we noted certain matters involving the internal control structure that we considered to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment, could adversely affect the organization's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable conditions are described below as findings (1), (2), and (3).

Our consideration of the internal control structure policies and procedures would not necessarily disclose all matters in the internal control structure that might constitute material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities that would be material to the financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. The reportable conditions described below as findings (1) and (2) are also considered to be material weaknesses.

(1) Cash and Investments Held by the Community Development Commission (CDC)

During our review of internal controls over cash and investments, we noted that the Community Development Commission's (CDC) cash and investments (held by both the CDC and its fiscal agent) had not been reconciled to the general ledger on a monthly basis. Sound internal controls dictate that the individual in charge of reconciling the cash and investment portfolio to the general ledger ensure that all cash and investment activities (i.e., purchases, sales, transfers, interest earnings) have been accurately and timely recorded in the general ledger. This procedure should be done soon after month end in order to efficiently detect and resolve any discrepancies or unauthorized transactions that might occur. It should be noted that cash and investments held by the CDC and its fiscal agent were reconciled at year end.

During our audit we also discovered that several checks included in the listing of outstanding checks on the bank reconciliation were actually voided checks that had not been voided in the accounting records. As a result, the expense accounts related to these checks were overstated and the checking account balance was understated by \$202,571. In addition, during our review of cash disbursements we noted that a check in the amount of \$36,351 had been cancelled and a separate check was reissued. However, the original check was not voided in the accounting system, which resulted in the recording of duplicate expenditures.

Recommendation

We recommend that the CDC reconcile and record all cash and investment activity to the general ledger on a regular monthly basis. We further recommend that the City and CDC consider the use of a third party custodian in performing investment transactions for all investments. The involvement of a third party custodian (separate and distinct from the institution that executes the investment purchase on the CDC's behalf) enhances the internal controls over investments by decreasing the risk of fraud by the counter party, the party that makes the investment purchase.

We further recommend that an individual review the bank reconciliation to ensure that only valid outstanding checks are listed. In addition, we recommend that when a check is requested to be reissued that the individual who approves the disbursement ensure that the original transaction has been voided in the accounting system.

Management Response

A process has been implemented for the timely reconciliation of the bank and investment statements to the General Ledger. The two Associate Accountants are assigned the task of completing the reports, which will be due 30 days after the end of the month. One of the Associate Accountants will reconcile the payroll and accounts payable accounts, ensuring that only valid outstanding checks are reported, revenues accurately posted to the proper accounts and investment activities properly recorded and reconciled. The other Associate Accountant will prepare the consolidated cash report of all CDC accounts and will ensure balances are correctly reflected in the General Ledger. The completed reports will be submitted to the Senior Accountant for review and approval.

Additionally, to be consistent with City procedure, the CDC now prepares the daily cash position report. The daily bank activity report generated prior to the preparation of this report is an important tool which allows staff to detect and report in a timely manner unauthorized bank transaction.

(2) Proper Recording of Grants and Contracts

It is important that the Finance Department of the City and CDC be informed about various grant and contract agreements entered into by other departments so that these agreements can be properly reflected into the accounting records. These agreements would include developer agreements that commit the City or CDC to make certain project related disbursements, as well as, state, federal and other grant agreements that provide for reimbursement to be received by the City or CDC for certain activities or projects. In addition, it is important that the Finance Department of the City and CDC be informed about grant reimbursement requests at year end. Reimbursement requests should be made timely and should be forwarded to the Finance Department so that the appropriate accounting adjustments can be made (i.e. accruals of receivables at year end, deferrals of revenues for amounts not received within the availability period, etc.). During our review of receivables we noted various over accruals and under accruals of receivables which resulted in four adjusting journal entries that amounted to over four million dollars in adjustments.

Recommendation

We recommend that the City and CDC establish a policy that requires that all grant agreements and other contracts with financial significance be submitted for sign-off by the Finance Director of the City and CDC. This would help ensure that such agreements are properly reflected in the accounting records. This will also permit finance to properly monitor these agreements to ensure that the related receipts and disbursements are recorded timely and accurately. Finance should also be informed of all grant applications. Since the City and CDC have numerous grants, the City and CDC may consider appointing a grants administrator to ensure compliance of all grant requirements (i.e. reporting, matching, allowable costs etc.). In addition, we recommend that grant reimbursement requests also be made timely and be forwarded to the Finance Department so that the appropriate accounting adjustments can be made at year end.

Management Response

Management concurs with the recommendation. All grant agreements and contracts with financial significance will be submitted to the Finance Director for sign off.

Finance staff will also work closely with staff responsible for grants in other departments to ensure proper recording and accounting of grant agreements. Regular meetings with departments' grant administrators will be scheduled regularly to monitor various aspects of grant compliance and reporting.

The positions of Grants Administrator and Grants Accountant are also being considered for authorization in FY 2007-2008 budget.

(3) Payroll

The Direct Deposit Report for payroll is reviewed by an individual prior to being sent to the bank for processing. After the Direct Deposit Report has been reviewed it is given back to payroll for processing. However, the Direct Deposit Report is not reviewed by anyone after it has been sent to ensure that no changes were made after the initial review. The risk is that the report be modified after the initial review which would not be detected since no one reviews the final Direct Deposit Report.

Recommendation

We recommend that an individual independent of the payroll function review the final Direct Deposit Report after it has been sent and agree it to the direct deposit confirmation from the bank and to the payroll register.

Management Response

Management concurs with the recommendation. The Senior Accountant will verify that the Direct Deposit Report agrees with the payroll register and the direct deposit confirmation report from the bank.

We noted the following matters involving the internal control structure and its operation that do not represent reportable conditions or material weaknesses in internal controls. We offer these recommendations as suggestions for consideration by the City to strengthen its internal control structure and to ensure compliance with government regulations.

(4) Inadequate Records on Housing Project Capital Assets

The CDC's Morgan Towers and Kimball Towers housing projects have not maintained adequate detailed records relating to their capital assets. Although adequate detailed records are maintained for current year additions and deletions to capital assets (and related accumulated depreciation), the CDC should maintain detailed records that reconcile to the total ending capital assets and related accumulated depreciation recorded in the general ledger in order to ensure such assets exist and that depreciation is correctly calculated.

Recommendation

We recommend that the CDC perform an inventory on all capital assets owned by their housing projects and that such records reconcile to the total ending capital assets and related accumulated depreciation recorded in the general ledger.

Management Response

The CDC will coordinate with the Kimball and Morgan Towers management to perform a physical asset inventory. Upon completion of the inventory, reconciliation will be made to match those assets and their values to the CDC's fixed asset accounting records.

(5) Redevelopment Agency Accounting

It is the current policy of the CDC to record eighty percent of tax increment money received in the Redevelopment Agency (RDA) Capital Projects Fund and twenty percent of tax increment money received in the Low and Moderate Housing Fund. A transfer is made from the RDA Capital Projects Fund to the RDA Debt Service fund to pay for current year principal and interest payments. Although this method is allowed, it is not the most acceptable method for accounting for tax increment in RDA funds.

Recommendation

We recommend that eighty percent of the tax increment received be recorded in the RDA Debt Service Fund rather than the RDA Capital Projects Fund. After all required RDA debt service payments are made in the RDA Debt Service Fund, the excess tax increment in the Debt Service Fund may be transferred to the RDA Capital Projects Fund to spend on allowable redevelopment projects. The twenty percent set-aside should continue to be recorded directly in the Low and Moderate Housing Fund.

Management Response

Management concurs. The CDC will record the receipt of 80% of the tax increment in the RDA Debt Service Fund. Residual amount after debt service and pass-through payments will be transferred to the RDA Capital Projects Fund.

(6) Consolidation of Funds in the Accounting System

Currently, the City has over one hundred funds in their accounting system. Although some funds are required to be reported separately, the majority of the City funds may be combined into the same fund if they are similar in nature (i.e. certain grants). Different revenue and expenditure accounts may be used to segregate those funds that are combined into one in order to continue to account for them separately.

Recommendation

We recommend that the City consider combining certain funds in their accounting system for ease of accounting and reporting.

Management Response

This recommendation was implemented in FY 2005-2006. Related grant funds received by a department, say the Fire Department, were combined into one fund described as Fire Department Grants. This combining process will be expanded to bring as many grants under one, or as few as possible, funds.

Management deemed it necessary to retain existing special revenue funds until projects are completed, all payments made, and all reimbursements received to complete the accounts' history and for ease of future reference.

(7) Controls over Cash Receipts

During our review of internal controls over cash receipts, we noted that the individual responsible for maintaining records for transient occupancy taxes (TOT) and parking citations also has physical access to customer payments. Transient occupancy taxes are collected monthly. The hotel owners or operators send checks to the City along with monthly transient occupancy tax returns. The individual that receives the checks maintains an excel spreadsheet with the amounts received from each hotel for each month. However, that spreadsheet is not reviewed by anyone. The individual could intercept a TOT check and the transaction may go undetected.

When a parking citation is issued that information is transmitted electronically by the police officers to Data Ticket Inc. Data Ticket Inc. maintains a database of the citations issued and payments made. Parking citations can be paid online through Data Ticket's website or in person at the City. When payments are made in person the individual that receives the customer's payment at the City emails Data Ticket so that Data Ticket's database is updated to reflect payments made at the City. The individual at the City could conceal theft of customer payments by emailing Data Ticket to indicate that payment has been made even though the payment was never deposited into the City's bank account.

Recommendation

We recommend that someone independent of the cash receipts function review transient occupancy tax revenue for reasonableness (i.e. spot check for 12 payments per each hotel, trace the payments to deposit on the bank statements, etc.). For parking citations we recommend that someone independent of the cash receipts function spot check the monthly billing report and agree those amounts to the cash register remittance and bank statements.

Management Response

Concurring with the recommendation, the Senior Accountant supervising the Revenue and Recovery division will review transient occupancy tax revenue for reasonableness and will verify that the monthly billing report for parking citations agree with the cash register remittance and bank statements.

(8) Investment Policy

The City's investment brokers have not been given a copy of an updated Investment Policy since 2002. There have been some minor changes to the Investment Policy since 2002 that should be communicated to the brokers. For example, in 2002 the City was allowed to purchase Certificates of Deposit with extended maturity dates beyond 2 years at the discretion of the Finance Director. However, the revised Investment Policy limits the City to holding Certificates of Deposit with maturities of less than 2 years.

Recommendation

We recommend that the brokers receive a copy of the most recent Investment Policy each year to ensure compliance with the Investment Policy. In addition, the City should confirm receipt of the policy with each of these brokers every year. The City may also want to consider requesting a quarterly certification letter from the broker confirming that they adhered to the City's policy.

Management Response

Shortly after the end of the fiscal year, copies of the investment policy were mailed to all the brokers. Accompanying the policy was an acknowledgement receipt to be signed by the broker and returned to the City. These signed acknowledgements have been received by the City. In addition, the City considers that an annual certification letter from brokers confirming adherence to the City's investment policy is sufficient.

(9) Cash Register Voids

Cash receipts are collected at the cashier window at City hall. Sometimes transactions are entered incorrectly and are subsequently voided. However, it was noted that explanations for voided transactions are not documented on the cash register recap reports. In addition, the cash register recap report is not reviewed for voided transactions. The risk is that a customer makes a payment at the cashier window and is given a receipt; however, afterwards the transaction could be voided and the customer payment could be intercepted.

Recommendation

We recommend that explanations be documented on the cash register recap reports for any voids. In addition, someone independent of the cash receipts function should review the cash register recap reports each day and should spot check voids for proper approval and reasonableness.

Management Response

As part of the internal control process, only senior staff independent of the cash receipt function is authorized to void a cash register transaction. Prior to voiding a transaction, the senior staff interviews the cashier for the reason of the void. Explanations for the void will also be documented on the cash register recap report. In addition, approval of senior staff is noted by initialing the report. The Senior Accountant who reviews the daily register recaps will also spot check voids for documentation and approval.

(10) Cash Disbursements

During our testing over cash disbursements, we noted that sometimes original invoices (hotel receipts, rental car receipts, etc.) are not attached to requests for warrants for employee reimbursements.

Recommendation

We recommend that original invoices be attached to requests for warrants for employee reimbursements in order to ensure that employees are only reimbursed for actual legitimate expenses that benefit or relate to the City.

Management Response

The Finance Department requires that all appropriate receipts be attached to requests for employee reimbursements. However, there are instances when receipts get lost. In these cases, the test of materiality is taken into consideration before paying these requests.

(11) Internal Controls over Capital Assets

During our review over capital assets, we noted that sometimes deletions to infrastructure are not always made when related additions are recorded. In addition, sometimes non-capitalizable items (i.e. slurry seals) were capitalized in the City's books as a capital asset when they should not have been.

Recommendation

We recommend that when additions to infrastructure roadways are recorded that the Engineering Department analyze those additions in order to determine whether those additions related to the removal of preexisting infrastructure. If the addition related to the removal of preexisting infrastructure engineering should communicate to finance what portion of the preexisting infrastructure should be deleted for each addition. We further recommend that additions be analyzed by engineering in order to ensure that projects that are capitalized are those allowed by the current accounting standards. For instance, slurry seals are considered maintenance which is a non-capitalizable item and would not be recorded as a capital asset in the City's books.

Management Response

Concurring with the recommendation, the Finance Department will work more closely with the Engineering Department to ensure that projects are properly classified, segmented, and capitalized only where appropriate.

(12) Competitive Bidding

During our testing over cash disbursements that were charged to the Transportation Development Act ("TDA") fund, we noted that sometimes proof of multiple bids was not maintained. The City's purchasing policy requires that purchases over \$15,000 go through a formal competitive bidding process.

Recommendation

We recommend that proof of multiple bids be maintained as evidence that the City has complied with its purchasing policy for competitive bidding.

Management Response

City policy requires competitive process for purchases over \$15,000.00. However there are allowable exceptions that are outlined in the Purchasing Ordinance, such as sole source or Council approved purchases. Proof of multiple bids and/or documentation of the exceptions are maintained by the Purchasing Department.

(13) Deficit Fund Balances

During our audit we noted that the following funds had fund deficits at June 30, 2006:

Section 8 Housing Assistance Special Revenue Fund	\$(1,418,747)
Library Construction Capital Project Fund	(1,347,239)
Nutrition Program Special Revenue Fund	(1,174,052)

Recommendation

We recommend that if the funds are not expected to have sufficient future revenues to eliminate the deficit, the City should consider subsidizing these funds from other non-restricted revenue sources.

Management Response

The Library Construction Capital Project Fund will receive additional funds from the State to eliminate this deficit. The subsidy of the other two funds, the Section 8 Housing and the Nutrition Program funds, will be addressed by management in the FY 2007-2008 budget.

This report is solely intended for the information and use of the management, City Council and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

Mayer Hoffman McCann P.C.

Irvine, California
November 30, 2006